

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**DUAL MANAGEMENT OF COMMERCIALY
AVAILABLE ITEMS - BATTERY, FOOD SERVICE,
AND PHOTOGRAPHIC PRODUCTS**

Report No. 98-037

December 12, 1997

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Department of Defense

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Acronyms

DLA	Defense Logistics Agency
FSC	Federal Supply Class
GSA	General Services Administration
NSN	National Stock Number



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December 12, 1997

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF DEFENSE
(LOGISTICS)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Dual Management of Commercially Available Items -
Battery, Food Service, and Photographic Products
(Report No. 98-037)

We are providing this report for review and comment. It is the second in a series of reports regarding dual management of commercially available items. The audit was requested by the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management). We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Defense Logistics Agency provide additional comments on Recommendations 2.a. and 2.b. by February 12, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Tilghman A. Schraden, Audit Program Director, at (703) 604-9186 (DSN 664-9186) (tschraden@dodig.osd.mil) or Mr. Terrance P. Wing, Audit Project Manager, at (215) 737-3883 (DSN 444-3883) (twing@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 98-037
(Project No. 6LD-5044.02)

December 12, 1997

Dual Management of Commercially Available Items - Battery, Food Service, and Photographic Products

Executive Summary

Introduction. The audit was requested by the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management). It is the second in a series of reports on dual management of commercially available items that discusses Defense Logistics Agency (DLA) managed items in 17 Federal supply classes (FSCs) for battery, food service, and photographic products. DLA managed 51,754 national stock numbered items in the 17 FSCs. For the 7-month period ended April 1997, DLA reported sales of approximately \$56.2 million and inventory of \$38.2 million for those FSCs.

Audit Objectives. The audit objectives were to determine the extent of products available through non-Defense Federal organizations for which DoD also operates central procurement programs and to evaluate whether the DoD programs are providing services without added benefit to DoD. The specific objective of this report was to determine the extent of DLA managed items in FSCs for battery, food service, and photographic products that were procured also by the General Services Administration (GSA). Subsequent reports will determine the extent of additional commodities available through non-Defense Federal organizations for which DoD also operates centralized procurement programs. We also reviewed the adequacy of the management control program applicable to the stated objectives.

Audit Results. The DLA managed battery, food service, and photographic national stock numbered items that were not predominantly military and that GSA centrally procured. Our random statistical sample indicated that 27,958 (61 percent) of 45,936* national stock numbered items managed by DLA in 17 FSCs were either procured by GSA or DLA and GSA contracted with the same vendors, but the items were not in GSA vendors' catalogs or the catalogs were not available for evaluation. As a result, there was no assurance that DLA resources expended to manage those items added value (cost economies and operational readiness) to either DoD or the DLA role as a combat support agency.

Additionally, DoD requisitioners ordering items through DLA generally could and did pay higher prices than if the same items were ordered through GSA and purchases were not consolidated under a single source of supply for potential price discounts.

* See Appendix A for an explanation of the national stock numbered items managed by DLA that were excluded from the audit universe.

No material management control weakness was identified. See Appendix A for details on the management control program.

Implementing the recommendations should reduce the duplication and result in DoD organizations paying less for required materiel. However, we could not quantify the potential monetary benefits because they are dependent on future review results and associated management decisions. See Part I for a discussion of the audit results.

Summary of Recommendations. We recommend that duplication between DLA and GSA in procuring battery, food service, and photographic products be eliminated and that DoD requisitioners be reminded that they have the authority to use sources of supply other than the integrated materiel manager, when the other sources of supply offer the best value.

Management Comments. The Acting Deputy Under Secretary of Defense (Logistics) concurred with the recommendations to eliminate duplication in procuring items in the FSCs included in the audit and to issue a reminder to the Military Departments concerning the flexibility they have in obtaining materiel from various sources of supply. By April 15, 1998, based on a written DLA analysis, the Acting Deputy will initiate coordination with GSA on the management of the items. Additionally, on October 24, 1997, the Acting Deputy issued a reminder to DoD organizations about the authority they have to purchase items from various sources of supply. The Deputy Director, DLA, partially concurred with the finding and agreed that both DLA and GSA procure DLA managed items. However, DLA is working to provide the customer multiple sources of supply and a range of services that include rapid delivery, contract administration, and quality assurance. Additionally, the 1971 agreement between DLA and GSA provides for DLA to manage FSCs commonly used in military operations or weapons system support irrespective of their use by civil agencies. The Deputy Director nonconcurred with the recommendation to provide a written analysis that identifies items that GSA is best suited to procure, and suggested that an analysis would be nonproductive. The Deputy Director concurred with the recommendation to provide justification for retaining the management of items in the FSCs that are not predominantly military or classified as nonessential. The Deputy Director stated that FSCs will be retained on the basis that DLA supports all requirements and provides the best overall price and service. See Part I for a discussion of management comments and Part III for the complete text of those comments.

Audit Response. Comments from the Acting Deputy were responsive. Comments from the Deputy Director, DLA, were not fully responsive. We recognize that DLA should manage items that are essential to military operations. Consequently, we did not recommend that all items in the supply classes be transferred to GSA. However, in this era of DoD downsizing and because of the Secretary of Defense's commitment to improve DoD business practices and eliminate redundancy in DoD operations, we believe that DLA resources should not be directed toward procuring common commercial items that are available to DoD customers through GSA. We request that DLA reconsider its position and provide additional comments on the final report by February 12, 1998.

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Part I - Audit Results

Audit Background

The audit was requested by the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management). This report, the second in a series of reports on dual management of commercially available items, discusses Defense Logistics Agency (DLA) managed items in 17 Federal supply classes (FSCs) (see Appendix B) for battery, food service, and photographic products. Inspector General, DoD, Report No. 97-205, "Dual Management of Commercially Available Items - Defense Logistics Agency Electronic Catalog Program," August 15, 1997, discusses duplication between the electronic catalog and General Services Administration (GSA) supply programs.

An FSC is a 4-digit code at the beginning of a national stock number (NSN) that designates the general commodity grouping of an item. DLA managed 51,754 NSNs in the 17 FSCs reviewed. For the 7-month period ended April 1997, DLA reported sales of approximately \$56.2 million and inventory of \$38.2 million for those FSCs.

Role of Deputy Under Secretary of Defense (Logistics). DoD Manual 4140.26-M, "Defense Integrated Materiel Management Manual for Consumable Items," June 1995, provides that the Deputy Under Secretary of Defense (Logistics) direct and administer the Defense Integrated Materiel Management Committee. One objective of the committee is to eliminate the duplication of effort in the wholesale materiel management of items.

DoD Manual 4140.26-M also provides integrated materiel management assignments for consumable materiel. Integrated materiel management responsibilities include cataloging, determining requirements, procuring, distributing, and disposing of materiel. According to the manual, DLA is assigned integrated materiel management for 499 FSCs and GSA is assigned management for 70 FSCs.

Role of DLA. The DLA is a combat support agency responsible for worldwide logistics support, including procuring; stocking; and issuing consumable items throughout DoD. The primary focus of DLA is to support military operations in peace and in war, and to provide relief efforts during national emergencies. As of March 1997, DLA managed approximately 4 million NSNs, of which about 1.5 million NSNs were coded as essential to the operation of the Military Department weapons systems.

Role of GSA. The GSA was established in 1949 to supply personal property to Government organizations. GSA operates a worldwide supply system to contract for and distribute personal property and services to Federal agencies. GSA provides items to its customers through several supply programs, Federal supply schedules, special order, and stock. GSA manages approximately 135,000 NSNs and has contracts with over 5,000 vendors for direct delivery of commercial items to customers.

Audit Objectives

The audit objectives were to determine the extent of products available through non-Defense Federal organizations for which DoD also operates central procurement programs and to evaluate whether the DoD programs are providing services without added benefit to DoD. The specific objective of this report was to determine the extent of DLA managed items in FSCs for battery, food service and photographic products that were procured also by GSA. We also reviewed the adequacy of the management control programs as they applied to the stated objectives. We were unable to determine the extent of products available through non-Defense Federal organizations, for which DoD also operates central procurement programs, because the number and value of those types of procurements are not centrally reported. See Appendix A for a discussion of the scope and methodology, the statistical sampling methodology, our review of the management control program, and the summary of prior coverage.

Dual Procurement of DLA Managed Items

The DLA managed NSNs for battery, food service, and photographic products that were not predominantly military and that were centrally procured by GSA. Our random statistical sample indicated that 27,958 (61 percent) of 45,936 NSNs managed by DLA in 17 FSCs were either procured by GSA or DLA and the GSA contracted with the same vendors, but items were not in GSA vendors' catalogs or the catalogs were not available for evaluation. This duplication occurred because DLA was assigned integrated materiel management responsibilities for NSNs that were not predominantly military. As a result, there was no assurance that DLA resources expended to manage those types of NSNs added value (cost economies and operational readiness) to either DoD or the DLA role as a combat support agency. Additionally, DoD requisitioners ordering items through DLA could and did pay higher prices than if the same items were ordered through GSA; and purchases were not consolidated under a single source of supply for potential price discounts.

DoD and GSA Supply Management Relationship

The DoD and GSA entered into an agreement in 1971 to eliminate avoidable duplication between their respective supply systems and those of other Federal agencies. The agreement also was to provide economical, effective, and responsive integrated materiel management to all Government agencies for commonly used commodities. With few exceptions, the agreement assigns to GSA the FSCs that Federal agencies commonly use, that are available on the civilian economy, and that are not predominantly military. The agreement also assigns to DLA the FSCs that are commonly used in military operations or

* See Appendix A for an explanation of the national stock numbered items managed by DLA that were excluded from the audit universe.

weapons systems support, regardless of their use by civil agencies. Recognizing that it is generally impractical to make exclusive FSC assignments, the agreement also provides exceptions to management for individual NSNs. All exceptions require an agreement between DLA and GSA. As of August 1996, DLA managed 15,496 NSNs in FSCs that were assigned to GSA, and GSA managed 2,463 NSNs in FSCs that were assigned to DLA.

On March 6, 1997, the Director, Defense Procurement, issued a policy memorandum, "General Services Administration Federal Supply Schedules as Preferred Sources of Supply," that established DoD policy on using GSA supply schedules. The memorandum urged DoD organizations to take full advantage of GSA Federal supply schedule contracts when needed services and supplies are covered by the contracts. The Director stated that recent changes mirroring commercial practices, to include use of the Internet, have made GSA schedules even more efficient to use. Additionally, use of schedule contracts meets DoD goals to simplify the acquisition process.

Procuring DLA Managed NSNs

The DLA managed battery, food service, and photographic NSNs that GSA centrally procured. We took a random statistical sample of 1,100 of 45,936 NSNs in the 17 FSCs to determine the extent of DLA and GSA procurement of the same items and their contracting with the same vendors. Appendix A provides data on the sample selection and the projected audit results.

The sample indicated that 27,958 (61 percent) of 45,936 NSNs managed by DLA were either procured by GSA or DLA and GSA contracted with the same vendors, but items were not in GSA vendors' catalogs or the catalogs were not available for evaluation. Of the 27,958 NSNs, 11,298 were procured by DLA and GSA. For the remaining 16,660 NSNs, DLA and GSA (under its Federal supply schedules program) contracted with the same vendors, but the items were either not in the GSA vendors' catalogs or the catalogs were not available for review. Most of the items procured were in FSCs related to food service and photographic products that DLA procured under central contracts for direct delivery to requisitioners.

Assignment of Integrated Materiel Management

The DLA was assigned integrated materiel management responsibilities for battery, food service, and photographic products that were not predominantly military and classified as nonessential to the operations of military weapons systems. DoD Manual 4140.26-M specifically assigned integrated materiel management responsibilities to DLA for 14 of the 17 FSCs and to GSA for the remaining 3 FSCs. For the NSNs assigned to GSA, DLA also had item management exception authority from GSA for 138 NSNs in those three classes.

The majority of NSNs managed by DLA were classified as nonessential to the operations of military weapons systems. GSA also procured the items assigned to DLA for integrated management that were not predominantly military. Further, DoD customers had the flexibility to purchase those items directly from GSA.

DLA Management of Nonessential Items. The majority of NSNs (47,774 of 51,754) managed by DLA in the 17 FSCs were classified as nonessential to the operations of military weapons systems (see table). A secondary item (consumable and repairable items other than principal items) of which its failure rendered the supported end items or weapons systems inoperable was considered an essential item. Materiel that does not qualify as mission essential is classified as nonessential. The Military Departments determined whether items were essential and provided essentiality data to DLA.

Battery, Food Service, and Photographic Product Essentiality Data

<u>Type of Product</u>	<u>Number of NSNs</u>	<u>Number of NSNs Coded as Nonessential</u>	<u>Nonessential (percent)</u>
Battery	3,565	2,564	72
Food Service	19,875	18,098	91
Photographic	<u>28,314</u>	<u>27,112</u>	96
Total	51,754	47,774	

Examples of nonessential items managed by DLA included a camera mount, coffee urn, deep fat fryer, dishwasher, electric range, film, ice cream cabinet, and icemaker. We were unable to determine why those types of nonessential NSNs were assigned to DLA for management (five of the FSCs were assigned to DLA in the 1971 agreement).

GSA Supply Schedules. The GSA centrally procured battery, food service, and photographic items assigned to DLA for integrated management. Federal supply schedule sales from those items in FY 1996 were approximately \$91.5 million. Federal supply schedules provided several advantages to Federal agencies. Agencies had the option of ordering small quantities of commonly used goods without using the traditional procurement process. Also, agencies knew that GSA was responsible for ensuring that all procurement regulations had been followed in awarding the schedule contracts and making items available.

The GSA was aware that it centrally procured battery, food service, and photographic products that were assigned to DLA for integrated materiel management. However, GSA personnel stated that when they negotiated Federal supply schedule contracts with vendors they did not eliminate items managed by DLA from the schedules because the schedules were negotiated for classes of items, not specific items.

Sources of Supply. Although DLA was the integrated material manager for the items evaluated, DoD customers had procurement flexibility. The Defense Federal Acquisition Regulation, part 208, "Required Sources of Supplies and Services," provides DoD requisitioners the authority and flexibility to use sources of supply other than the integrated materiel manager when the purchase is in the best interest of the Government for the combination of cost, quality, and timeliness. GSA offered lower prices for many of the same items that DLA provided. DoD customers may have overlooked that fact because DLA had been the integrated material manager, in some cases, for as many as 26 years. Therefore, DoD customers should be reminded of the flexibility that the Defense Federal Acquisition Regulation provides organizations in obtaining required materiel.

Value Added by DLA Management of Nonessential Items

The DLA management of nonessential battery, food service, and photographic products did not add value either to DoD or to the DLA role as a combat support agency. DLA expended resources to procure nonessential items that were readily available through GSA supply programs. Additionally, DLA customers could and did pay higher prices for materiel that was also available through GSA; DLA incurred unnecessary storage and handling costs by procuring and stocking materiel that was available through GSA supply schedules; and purchases were not consolidated for possible price breaks.

Resources Used to Manage Nonessential Products. The DLA used resources to manage nonessential battery, food service, and photographic products that duplicated the GSA supply programs. Having two Government organizations operating centralized programs that compete with each other in procuring the same type of items, in some cases from the same vendor, did not contribute to the economy and efficiency of the Government. In this period of downsizing, DLA could use its resources more efficiently by managing those items that are essential to weapons systems.

Price Comparison of Sample Items. DoD requisitioners ordering through DLA could and did pay higher prices for items that were available through GSA. We identified 209 items that were available for procurement from both organizations. In our comparison of prices that customers would pay for 96 of 209 items, GSA was lower for 86 items (2 to 80 percent), and the DLA price was lower for 10 items (2 to 36 percent). We could not make a determination for the remaining 113 items because DLA procurement records indicated that DLA had not procured 34 of the items for at least 2 years. For the 79 remaining items, the transportation charges were included in the DLA price, but not in the GSA price. The DoD customer would have to determine whether transportation charges for GSA items would result in an overall lower cost for the item than the DLA price. Examples of the price differences follow.

- o NSN 7310-00-355-8368, kettle, steam jacket, is available through a GSA Federal supply schedule for \$6,798.96. DLA sells the item for \$8,054.10, or \$1,255.14 (18 percent) more than GSA.

- o NSN 4110-01-373-8527, icemaker, was available through a GSA Federal supply schedule for \$4,034. DLA sells the item for \$3,386.31, or \$647.69 (16 percent) less than the GSA price.

DLA Procurements Using GSA Federal Supply Schedules. The DLA procured materiel using GSA supply schedules for depot stocks and direct vendor delivery to its customers. As a result, DLA incurred storage and handling costs for depot stocks that requisitioners could have ordered directly from GSA, and DoD requisitioners were charged a DLA cost recovery rate.

In FY 1996, the Defense Supply Center Richmond procurement records showed that the supply center issued \$14.3 million of purchase orders with GSA. We judgmentally took a sample of 50 purchase orders, valued at about \$3.2 million, to determine the types of items procured. Of the 50 purchase orders, 25, valued at approximately \$1.1 million, were for photographic products. Of the remaining 25 purchase orders, 19 were for FSCs related to chemical speciality items, duplicating products, and physical testing equipment. The last six either were canceled or were for services, not for materiel.

Costs Incurred for Stocked Items. The DLA incurred unnecessary storage and handling costs for materiel procured from GSA. From the 25 purchase orders for photographic products, we identified 18 NSNs that were procured from GSA to replenish DLA wholesale depot stocks for resale at a later date. For one of the NSNs, DLA had an on-hand balance of 6,983. The balance equated to 24 years of stock on hand (quarterly demand for the item was 71).

Cost Recovery Rate. The DLA added a cost recovery rate to the price it paid GSA for materiel ordered from GSA Federal supply schedules that DLA sold to its customers. DLA added the cost recovery rate to recoup costs for procuring, stocking, and delivering materiel.

DoD customers could have obtained materiel directly from GSA at prices lower than those DLA charged. For example, on April 22, 1996, the Defense Supply Center Richmond, using a GSA Federal supply schedule, placed a delivery order with a vendor for color print film. GSA charged the supply center \$34,842 for the film. The vendor shipped the film directly to the Marine Corps Air Station in Yuma, Arizona. The Defense Supply Center Richmond added a 45-percent cost recovery rate to the GSA price and billed the customer \$50,572.80, \$15,730.80 more than the GSA price.

Consolidation of Purchases. With the Federal Government operating two central procurement programs for battery, food service, and photographic products, purchases were not consolidated under a single source of supply for potential lower prices. In 1993, the National Performance Review reported that consolidating purchasing actions would benefit the taxpayer through greater volume discounts and simplified administration. Vendors have reduced order processing and administrative expenses for large quantity orders and generally will pass on to their customers any savings or volume discounts. If the duplication between DLA and GSA were eliminated, the Government could consolidate purchases to take advantage of potential lower vendor prices.

Summary

The types of items that DLA managed in the 17 FSCs we reviewed were primarily commercial items that were readily available through GSA supply programs. By managing those types of items, there was no assurance that DLA was effectively using its resources to manage essential military items to accomplish its mission as a combat support agency. An assessment of each NSN within the 17 FSCs is needed to determine whether DLA should retain management of the item or whether management of the item is more appropriately a responsibility of GSA. As noted in the Director, Defense Procurement, policy memorandum on procurement through GSA, DoD organizations should take full advantage of GSA supply schedules.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Deputy Under Secretary of Defense (Logistics):

a. Eliminate the duplication in procuring items in Federal supply classes for batteries, food service equipment, and photographic products, by coordinating the management of those items with the General Services Administration based on a written analysis from the Defense Logistics Agency.

b. Issue a reminder to the Military Departments that DoD organizations have the authority and flexibility under existing procurement regulations to use sources of supply other than the integrated materiel manager, when the other sources offer the best value.

Under Secretary of Defense (Logistics) Comments. The Acting Deputy Under Secretary of Defense (Logistics) concurred. The Acting Deputy stated that coordination with GSA will be initiated by April 15, 1998, based on a DLA analysis of the supply classes for batteries, food service equipment, and photographic products. Additionally, on October 24, 1997, the Acting Deputy issued a memorandum to remind DoD organizations of the existing authority and flexibility to use sources of supply other than the integrated materiel manager, when the other sources offer best value.

2. We recommend that the Director, Defense Logistics Agency, provide the Deputy Under Secretary of Defense (Logistics) a written analysis that:

a. Identifies specific national stock numbered items in the 17 Federal supply classes that are included in the audit for which the General Services Administration is best suited to procure.

b. Justifies retaining integrated materiel management of national stock numbered items in Federal supply classes for batteries, food service, and photographic products that are not predominantly military or classified as nonessential.

DLA Comments. The Deputy Director, DLA, nonconcurred with Recommendation 2.a., and stated that an individual item analysis of 46,000 NSNs is not productive. However, the Deputy Director stated that DLA will work jointly with GSA to determine the best possible manager and wholesale supporter for each of the 17 FSCs in question.

Regarding Recommendation 2.b., the Deputy Director concurred and stated that the justification will be provided by March 31, 1998, and will be the result of negotiations with GSA.

Audit Response. The DLA comments were not responsive. DLA stated that it is not productive to review individual NSNs in the FSCs; therefore, its response addressed transferring integrated materiel management responsibilities for all items in the FSCs to GSA. The DLA response did not address the intent of the recommendations, which is to identify specific NSNs for common commercial items that are not essential to military operations and NSNs that would be best suited for procurement by GSA. We recognize that DLA manages items in FSCs that are essential to military operations. Consequently, we did not recommend to transfer all items in the FSCs to GSA.

We disagree that an item analysis of 46,000 NSNs to determine those NSNs that should be procured by GSA is not productive. In this era of DoD downsizing and the Secretary of Defense's commitment to improve DoD business practices and eliminate redundancy in DoD operations, an analysis would provide an excellent opportunity for DLA to support the Secretary's commitment and enhance its role as a combat support agency. Eliminating the unnecessary management of commercially available items would allow DLA to concentrate its valuable diminishing resources on those items essential to military operations. We request that DLA reconsider its position and provide additional comments on the final report.

DLA Comments on the Finding and Audit Response

A summary of DLA comments on the finding and our response are in Appendix C.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed DoD and DLA supply and procurement records, and GSA procurement records to identify NSNs that both DLA and GSA procured. We also used the records to identify vendors that supplied products to both organizations and the prices that each organization charged its customers for the products. Specifically, we reviewed Federal Logistics Information System total item records, DLA supply control studies, national inventory records and procurement histories, and GSA Federal supply schedule procurement data. The documentation we reviewed covered the period from April 1996 through July 1997.

Use of Computer-Processed Data. We used computer-processed supply management data provided by DLA from the Federal Logistics Information System. To the extent that we reviewed the computer-processed data, we concluded that the data were sufficiently reliable to be used in meeting our objectives. We did not audit the systems that produced the data or assess relevant general and application controls.

Audit Type, Dates, and Standards. We performed this economy and efficiency audit from January through July 1997 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD and GSA. Further details are available on request.

Statistical Sampling Methodology

The Quantitative Methods Division, Inspector General, DoD, developed the statistical sampling plan for this audit. The purpose of the sampling plan was to assess the extent that DLA and GSA procured the same items for NSNs in 17 FSCs for batteries, food service, and photographic products.

Audit Universe. Based on the audit request from the Assistant Deputy Under Secretary of Defense (Material and Distribution Management), we selected three commodities (batteries, food service, and photographic products) to evaluate. DLA provided the audit team a database containing approximately 3.84 million NSNs managed by all the DLA supply centers except the Defense Fuel Supply Center. The database included 51,754 NSNs in the 17 FSCs we reviewed.

We used the DLA database to select NSNs for battery and photographic products. There were 31,879 NSNs in the two commodities. We excluded 5,032 NSNs from the audit universe for the two commodities because those NSNs either were coded for local procurement or were terminal items.

The database also included NSNs for 19,875 food service products. However, instead of using the DLA database to select food service NSNs for review, we used a universe of 19,069 NSNs that were included in a Defense Industrial Supply Center initiative to expand its sales of food service products. We used those NSNs because, under the initiative, the NSNs would be delivered directly from the vendor to DLA customers, similar to the GSA Federal supply schedule program.

Sampling Plan. We used a multistage statistical sample design for determining whether NSNs managed by DLA were also procured by the GSA. Using the commodity groups as strata, we drew simple random samples of NSNs from within each of the three commodity groups as shown in Table A-1.

Table A-1. Commodity Group Universe and Sample

<u>Group Name</u>	<u>Universe NSN Count</u>	<u>Sample NSN Count</u>
Batteries	2,840	338
Food Service Products	19,069	384
Photographic Products	24,027	378
Total	45,936	1,100

Appendix A. Audit Process

Sample Results. In terms of actuals (the sample NSNs themselves), GSA procured 209 of the 1,100 NSNs that DLA managed, and for an additional 357 of the 1,100 NSNs, DLA and the GSA contracted with the same vendors. However, the items were not in the GSA vendors' catalogs or the catalogs were not available for evaluation.

The project team assessed each sample item and determined whether:

- o there was a perfect match for it in the GSA system (same item procured);
- o the GSA schedule showed the manufacturer as one of the suppliers, though the items were not matched; or
- o there was no match of either the item or the manufacturer. We made three attribute projections as shown in Table A-2.

Table A-2. Attribute Projection

	<u>NSN Match</u>	<u>Vendor Match Only</u>	<u>Total</u>
Point Estimate	11,298	16,660	27,958
Lower Bound	9,986	15,292	26,546
Upper Bound	12,209	18,027	29,369
Sample Items with this Attribute	209	357	566

The results are interpreted as follows, using the NSN match items as an example. Based on the sample results for the 209 NSN matches, we projected with a 95-percent confidence that between 9,986 and 12,209 of the 45,936 items in the universe would have matches in the GSA system. Our best single estimate was that 11,298 of the 45,936 would have matches. Likewise, we projected with a 95-percent confidence that between 15,292 and 18,027 of the 45,936 items would have vendor matches in the GSA system. Our best single estimate was that 16,660 of the 45,936 would have vendor matches. The sampling formulae we used was from Schaeffer, Mendenhall, and Ott, "Elementary Survey Sampling," 4th Edition, Boston: PWS Kent, 1990.

Management Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the DLA management controls to avoid duplication of effort in the wholesale materiel management of items. Because we did not identify a materiel weakness, we did not assess management's self evaluation.

Adequacy of Management Controls. The DLA management controls were effective in that we identified no material management control weakness.

Summary of Prior Coverage

Inspector General, DoD, Report No. 97-205, "Dual Management of Commercially Available Items - Defense Logistics Agency Electronic Catalog," August 15, 1997. The report states that portions of the DLA electronic catalog program duplicated GSA supply programs, particularly the Federal supply schedule and Advantage programs. The report recommended that duplication between the electronic catalog and GSA supply programs be eliminated and that management controls be established to prevent duplication of DLA commercial item procurement initiatives with centralized procurement programs of other Government organizations. DLA nonconcurred with the recommendations and stated that the electronic catalog supports the National Performance Review and as such, DLA is required to reengineer its business practices to implement new ways and better ways of doing business in support of its customers. DLA further stated that the 12- to 18-month catalog operational demonstration period will provide valuable sales information to determine which commercial catalog items are most important in the operational support of the Armed Forces and to do otherwise compromises the pilot test, removing the capability of DLA to effectively evaluate the new supply support concept. We believe that the recommendations are valid, and audit mediation action is in process.

Appendix B. FSCs Reviewed

<u>Products</u>	<u>FSC</u>	<u>Description</u>
Battery	6135	Batteries, nonrechargeable
	6140	Batteries, rechargeable
Food Service	4110	Refrigeration equipment
	7310	Food cooking, baking, and serving equipment
	7320	Kitchen equipment and appliances
	7330	Kitchen hand tools and utensils
	7340	Cutlery and flatware
	7350	Tableware
	7360	Sets, kits, and outfits food preparation and serving
Photographic	6710	Cameras, motion picture
	6720	Cameras, still picture
	6730	Photographic projection equipment
	6740	Photographic developing and finishing equipment
	6750	Photographic supplies
	6760	Photographic equipment and accessories
	6770	Film, processed
	6780	Photographic sets, kits, and outfits

Appendix C. DLA Comments on the Finding and Audit Response

The following is a summary of the DLA comments on the draft report finding and the audit response to those comments.

DLA Comments on Dual Procurement and GSA Capabilities. The DLA partially concurred with the finding. DLA stated that it agrees there is procurement of DLA managed items by both GSA and DLA. There may be thousands of instances where items are commonly used in military operations and purchased by DLA, but are also commercial in nature and purchased by GSA. DLA stated that drawing a line between DLA and GSA reduces customer options in obtaining materiel and different sources of supply provide a range of services, including rapid delivery; contract administration; and quality assurance that were not considered by the auditors. Also, the 1971 agreement between DLA and GSA provides for DLA to manage classes commonly used in military operations or weapons system support irrespective of their use by civil agencies. The agreement does not require that the items meet any weapons system essentiality criteria.

The DLA further stated that as a combat support agency, it is committed to support its military customers during both peacetime and wartime across a broad spectrum of consumable item logistics requirements. GSA is selective about the items it chooses to buy with the presumption that DLA will buy those items needed by the Services that GSA will not buy. DLA does not believe that GSA is able to provide the full range of support for military used items.

Additionally, DLA stated that the philosophy that created DLA and GSA is that each should be technically competent within a given industrial sector and leverage Federal buying power for the benefit of military customers and taxpayers. The FSC structure and the assignment of integrated materiel management responsibility by FSC is consistent with that philosophy. Transfer of the FSCs that are under discussion makes sense if GSA could provide the best overall service to the military customer and if GSA will be committed to supporting all requirements, under all scenarios within an FSC. DLA stated that it makes little sense to transfer an FSC to GSA while retaining a few "oddball" items for which DLA cannot maintain technical expertise or market leverage. Finally, DLA stated it is also worth noting that many of the auditors' conclusions are based on old procurement practices whereby DLA individually bought, stocked, and issued material to customers.

Audit Response. One of the reasons for the 1971 agreement between DLA and GSA was to unite DLA and GSA in a common objective to eliminate avoidable duplication between their respective supply systems. The agreement does draw a line between the two organizations in managing items by FSC and recognizes that it is generally impractical to make exclusive FSC assignments by allowing flexibility for item management exceptions.

Appendix C. DLA Comments on the Finding and Audit Response

Our audit disclosed significant duplication between the two organizations for items in supply classes that are, in accordance with the agreement, assigned to DLA for materiel management. We did not evaluate the reasons why GSA is procuring the items, and we do not believe that the reasons are relevant in reengineering and improving DoD business practices. The items in which we question the need for DLA management are common commercial items, not items that are essential to the operations of the military.

The DLA is correct in that the 1971 agreement does not require that items must meet weapons system essentiality criteria for DLA to manage the items. However, essentiality criteria, which indicates the degree to which the failure of an item affects the ability of a weapon system to perform its intended operation or end item readiness, is one method to distinguish between items that are predominantly military and those that are not. Additionally, DLA provides intensive management (for example, funding and personnel) of items coded as essential. We recognize that GSA is not capable of providing the full range of items needed to support the military and we did not intend for DLA to transfer procurement responsibility for essential items to GSA.

Contrary to the DLA comments, we did consider services such as rapid delivery, contract administration, and quality assurance. The majority of items involved in the duplication between DLA and GSA were items that DLA procured under central contracts, similar to the GSA Federal supply schedule program. The items are common commercial items that the vendors provide to DoD, non-DoD Federal organizations, and the general public. Delivery times in the contracts were standard commercial timeframes and rapid delivery would be the exception, not the norm. Additionally, we do not believe that contract administration and quality assurance are relevant to common commercial items.

Other DLA Comments. The DLA stated that there were some shortcomings in the audit report. It stated that the report included a misconception of the term "nonessential" items by defining them as not being a part of a weapons system when they may still be essential to troop support and incorrect calculations relative to examples in the report. Also it stated that the report lacked a price analysis to consider the DLA surcharge, which covers important readiness costs such as testing and special packaging; and it lacked a cost and benefit analysis associated with the audit recommendations.

Audit Response. Where appropriate, we revised the calculations in the examples. The DLA surcharge does cover readiness costs such as testing and special packaging, but those costs should not apply to the types of items in question. Regarding the cost and benefits to implement the recommendations, we believe that the benefits far outweigh the costs. DoD resources would not be used to duplicate GSA supply programs and would be directed toward managing essential weapons system items. To identify and transfer items that are not predominantly military should be a one-time cost; whereas, eliminating the duplicate management would provide recurring cost avoidances and other benefits over the life of the programs.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Deputy Under Secretary of Defense (Logistics)
Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management)
Director, Defense Logistics Studies Information Exchange
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Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
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Senate Committee on Armed Services
Senate Committee on Governmental Affairs
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House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
 Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
 Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Deputy Under Secretary of Defense (Logistics) Comments



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

22 OCT 1997

(L/MDM)

MEMORANDUM FOR DOD INSPECTOR GENERAL
THROUGH: CHIEF, CAIR *W*

SUBJECT: Draft Audit Report, "Dual Management of Commercially Available Items-Battery, Food Service, and Photographic Products," Dated September 3, 1997 (Project No. 6LD-5044.02)

This responds to your memorandum of September 3, 1997, on the subject draft audit report. This review was conducted at the request of this office, and we appreciate the work done by your staff in performing this review. One recommendation, in two parts, was addressed to this office. Our detailed comments on that recommendation are included in the attachment.

R. R. Willis
Roy R. Willis
Acting Deputy Under Secretary
of Defense (Logistics)

Attachment

Deputy Under Secretary of Defense (Logistics) Comments

"1. We recommend that the Deputy Under Secretary of Defense (Logistics):

- A. Eliminate the duplication in procuring items in Federal supply classes for batteries, food service equipment, and photographic products, by coordinating the management of those items with the General Services Administration based on a written analysis from the Defense Logistics Agency.
- B. Issue a reminder to the Military Departments that DoD organizations have the authority and flexibility under existing procurement regulations to use sources of supply other than the integrated materiel manager, when the other sources offer the best value."

We concur with the recommendation. By October 31, 1997, we will issue a reminder to the Military Departments of the existing authority and flexibility to use sources of supply other than the integrated materiel manager, when the other sources offer the best value. By April 15, 1998, we will initiate coordination with the General Services Administration of management of items in Federal supply classes for batteries, food service equipment, and photographic products. The goal of this coordination will be elimination, wherever possible, of duplication of management of these items. The coordination of management of items in these classes will be based on a written analysis from the Defense Logistics Agency, to be received no later than March 31, 1998.

ATTACHMENT

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY
REFER TO

DDAI

OCT 30 1997

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Dual Management of Commercially Available Items -
Battery, Food Service and Photographic Products, 6LD-5044.02

Enclosed are our comments to your request of 3 September 1997. Should you have any
questions, please call Mrs. Elaine Parker, 767-6264 or Sharon Entsminger, 767-6267.

Encl


JEFFREY GOLDSTEIN
Chief (Acting), Internal Review

cc:
MMBCA
MMLSC

SUBJECT: Dual Management of Commercially Available Items - Battery, Food Service and Photographic Products, 6LD-5044.02

FINDING A: Dual Procurement of DLA Managed Items (Pg 4 of the Draft Rpt)

DLA COMMENTS: Partially concur. While we agree there is procurement of DLA managed items by both GSA and DLA, there may be thousands of instances where items are commonly used in military operations and purchased by DLA, but are also commercial in nature and purchased by GSA. The National Performance Review, and ensuing initiatives to enhance business practices, have placed DLA in a state of transition as far as traditional item management and the contractual means used to support the customer. Many initiatives are underway; e.g., the DLA Electronic Catalog Pilot Program, and until these have been tested and evaluated, occasion exists for duplication. We believe the customer is, above all, the key decider as to the best source of supply and we are working to provide him multiple sources for material. Drawing a line between DLA and GSA items reduces customer options. Different sources provide a range of services that includes rapid delivery, contract administration, quality assurance, and warranties (in addition to price); most of these factors were not considered by the auditors. The 1971 agreement between GSA and DLA allows for DLA management of those FSCs or commodities commonly used in military operations or weapons system support irrespective of their use by civil agencies. The agreement does not require the items meet any weapon system essentiality criteria.

DLA, as a Combat Support Agency, is committed to support its military customers during both peace and war across a broad spectrum of consumable item logistics requirements. GSA focuses on buying commercial items at a low price for the Federal customer, DoD being the largest. This has resulted in GSA being selective about which items they choose to buy with the presumption that DLA will buy those items needed by the Services that GSA will not. For example, during the Consumable Item Transfer, GSA refused to accept for management items in their assigned FSCs because of the item's military use and an expectation of low sales. In addition, we do not believe GSA is able to provide the full range of support for military used items.

The philosophy that created both DLA and GSA is we each should be technically competent within a given industrial sector and leverage Federal buying power for the benefit of military customers and taxpayers. The Federal Supply Class (FSC) structure and the assignment of integrated material management responsibility by FSC is consistent with this philosophy. That is why, as the report documents, there is very little exception management of items between DLA and GSA. Transfer of the FSCs under discussion makes sense if GSA could provide the best overall service to the military customer and **will be committed to supporting all requirements, under all scenarios** within a FSC. For example, food service equipment may be mostly commercial, but steam cookers on ships must operate when inclined 15 degrees with no product spillage, must withstand intense vibration/motion, and be able to pass through ship hatches. We doubt GSA contracts support these unique items. It makes little sense to transfer a FSC to GSA but retain a few "oddball" items for which we cannot maintain technical expertise or exert market leverage. It is also worth noting that many of the auditor's conclusions were based on old procurement practices whereby DLA individually bought, stocked, and issued material to

Defense Logistics Agency Comments

customers. We are moving away from that process to make customer requirements available directly from suppliers, thus improving customer support.


We note also some shortcomings in the audit report: 1) the lack of consideration of key factors in DLA support contracts such as delivery, quality, and warranties 2) a lack of customer input relative to the value of DLA support 3) the nondevelopmental nature of many items due to modifications required for military support 4) a misconception of the term "nonessential" items by defining them as not part of a weapon system when they may still be essential for troop support 5) incorrect calculations on p. 8 relative to certain NSNs (DLA sells 7310-00-355-8368 for 5% not 16% more than GSA and sells 4110-01-373-8527 for 19% rather than 16% less than GSA) 6) a lack of price analysis to consider the DLA surcharge, a significant component of prices, which covers important readiness costs such as testing, transport, special packaging, surge requirements, War Reserves, etc. 7) a lack of any cost/benefit analysis associated with the audit recommendations.

ACTION OFFICER: Linda Hanna, MMLSC, (703)767-1521

REVIEW/APPROVAL: D. P. Keller, RADM, SC, USN, Exec. Director, Logistics Mgmt

COORDINATION: Elaine Parker, DDAI, 767-6264

DLA APPROVAL:



E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

SUBJECT: Dual Management of Commercially Available Items - Battery, Food Service and Photographic Products, 6LD-5044.02

RECOMMENDATION 2: Recommend that the Director, Defense Logistics Agency, provide the Deputy Under Secretary of Defense (Logistics) a written analysis that:

- a. Identifies specific national stock numbered items in the 17 Federal supply classes that are included in the audit for which the General Services Administration is best suited to procure.
- b. Justifies retaining integrated materiel management of national stock numbered items in Federal Supply Classes for batteries, food service and photographic products that are not predominantly military or classified as nonessential.

DLA COMMENTS:

2a. Nonconcur. As suggested by the response to Finding A, an individual item analysis of 46,000 NSNs is not productive. Since GSA is technically competent within given industrial sectors and can leverage the Federal buying power for the benefit of both the military customer and the U.S. taxpayer, we will jointly work with them to determine the best possible manager and wholesale supporter for each of the 17 FSCs in question. Be mindful that this will include the full range of support to our mutual military customers.

2b. Concur. The justification requested will be the result of our negotiations with GSA. Any FSCs retained will be on the basis that DLA best supports all requirements and provides the best overall price and service to the military customer during both peace and war.


DISPOSITION: Ongoing. ECD: 31 Mar 98

ACTION OFFICER: Linda Hanna, MMLSC, (703)767-1521

REVIEW/APPROVAL: D. P. Keller, RADM, SC, USN, Exec. Director, Logistics Mgmt

COORDINATION: Elaine Parker, DDAI, 767-6264

DLA APPROVAL:


E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

Audit Team Members

This report was prepared by the Readiness and Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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